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SUBJECT: KAZAKHSTAN: ENTREPRENEUR NURLAN KAPPAROV DESCRIBES
ECONOMIC SITUATION, BUSINESS OPPORTUNITIES

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11. (U) Sensitive but unclassified. Not for public Internet.

12. SUMMARY: During a January 22 meeting with the Ambassador, Kazakhstani entrepreneur Nurlan Kapparov stressed the need for further banking-sector reforms and signaled his approval of the recent appointment of Grigoriy Marchenko to head the National Bank. Kapparov expects a devaluation of the tenge. He named agriculture, real estate and construction, oil services, and renewable energy as sectors of the economy with great potential for development over the long-run. Kapparov defended Kazakhstan's stringent work permits system for foreigners as necessary to ensure that foreign enterprises train local workers to take over positions in their companies. He said that the Lancaster Group that he heads has plans to build a plant in Astana to manufacture polysilicon for solar panels, but has had difficulty thus far in attracting the necessary financing. END SUMMARY.

BANKING SECTOR NEEDS FURTHER REFORM

13. (SBU) Kazakhstani entrepreneur Nurlan Kapparov -- the 38-year-old, Harvard-educated, head of the Lancaster Group holding company -- told the Ambassador on January 22 that the government's financial assistance to the banking sector (which is aimed at mitigating the effects of the global financial crisis) will be wasted if further banking reforms are not implemented. The banking sector's problems, he argued, go beyond the financial crisis, but "no one paid attention" when concerns were raised earlier about the quality of the country's top banks. Kapparov suggested that bank oversight is made more difficult by the fact that the Financial Supervision Agency (FSA), which is responsible for bank regulation, is independent and does not report to the National Bank. He signaled his approval of the recent appointment of banker Grigoriy Marchenko to be chairman of the National Bank. Kapparov described Marchenko -- who previously served as National Bank head during 1999-2004 -- as uniquely qualified for the job, having been the lead figure in establishing Kazakhstan's banking sector a decade ago. He maintained that Marchenko is likely to have unofficial control over the FSA, pointing out that FSA head Yelena Bakhmutova is a Marchenko protege. This could be the first step toward a merger of the two

agencies, Kapparov added.

TENGE DEVALUATION EXPECTED

14. (SBU) The Ambassador asked Kapparov whether he believes the tenge will be devalued relative to the dollar. Kapparov first noted that he has his own direct experience in banking, since the Lancaster Group holds a majority stake in KazInvestBank. (NOTE: The EBRD and Citibank hold the remaining shares. END NOTE.) He said he expects a devaluation, arguing that the government cannot sustain the current exchange rate for much longer. Kapparov pointed out that the currencies of several of Kazakhstan's major trading partners, notably the Russian ruble, have fallen in value recently, worsening Kazakhstan's terms of trade. This fact in particular, he contended, argues for the tenge's devaluation.

GREAT POTENTIAL IN AGRICULTURE

15. (SBU) In response to a question from the Ambassador, Kapparov enumerated several sectors of the economy which he believes have great long-term potential for development. Agriculture, he said, should be a particular focus for the country. According to Kapparov, the agricultural sector is already "quite strong," with several billion-dollar companies, including some that control vast agricultural land tracts. With the introduction of new technology to raise productivity, the country's agricultural output could be increased two-fold or more, he maintained. Unlike energy consumption, which fluctuates with economic conditions, food consumption is relatively stable. In China, increasing urbanization is leading to growing food demand that domestic production cannot keep up with, Kapparov contended. He noted that Arab investors, often a bellwether, have made large investments in Kazakhstani agriculture through private equity funds, and are considering additional acquisitions.

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BULLISH ON REAL ESTATE AND CONSTRUCTION

16. (SBU) Kapparov is also bullish about real estate and construction over the long-term, but admitted that recovery of those sectors ultimately depends on the world economy. He pointed out that following the fall of the Soviet Union, half-finished construction projects sat idle for years. Once the economy picked up in the late 1990s, a lot of those projects were finally finished off. Kapparov predicted that within three or four years, currently idle projects will be completed.

DEFENSE OF WORK PERMITS SYSTEM

17. (SBU) Kapparov believes that the oil services sector has great potential for domestic Kazakhstani companies, in particular because of the government's local content requirements. He pointed out that ERSOI Caspian Contractor, a joint venture between Lancaster and Italy's Saipem, is Kazakhstan's largest oil services company, with major contracts to provide support to the Kashagan project. The Ambassador explained that Western companies are concerned about local content requirements, as well as Kazakhstan's stringent work permits system that can make it difficult to bring in necessary expatriate personnel. Kapparov, however, insisted that the work permits system is essential in pushing companies to train locals so that they have the skills to ultimately take over positions in foreign companies. He indicated that he has put this into practice at ERSOI: the company, which was established in 2003, currently has 1500 employees, only 100 of whom are expats, and is training a Kazakhstani to take over as CEO in two years.

PLANS FOR POLYSILICON PLANT

18. (SBU) Kapparov cited renewable sources of energy as another sector with great potential for Kazakhstan. He explained that the Lancaster Group has developed a project to build a \$400 million polysilicon plant in Astana, but is struggling to come up with the financing. According to Kapparov, the plant would manufacture four percent of the world's supply of polysilicon for solar panels, using industrial polysilicon produced by factories in Karaganda and

Taldykorgan. He had already met with Prime Minister Masimov the previous day to discuss the project, and is working with the Samruk-Kazyna National Welfare Fund to attract debt financing. Unfortunately, the government itself is strapped for funds, he explained. According to Kapparov, the Lancaster Group was offered the opportunity to build the plant in Abu Dhabi, but made a political decision to construct it in Astana to support the development of a domestic renewable energy sector. This plant is the first step in developing a domestic solar industry. In the future, Kazakhstan could be home to solar energy farms providing electricity for domestic usage, as well for export to neighboring countries, including both China and Russia, Kapparov explained.

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